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HR Design News Corner: Pay for Performance

In discussing pay and performance management systems during the nationwide focus groups, DHS employees said that exceptional performers should be rewarded more consistently and frequently. At the same time, however, they liked the familiarity and predictability of the current pay system and expressed some concerns about performance-based systems.

For example, employees had questions about how pay would be based and how individuals could progress on the pay scale. They also wanted to ensure consistency and fairness in the way the system was administered. Additionally, they felt that the system should reward all employees who met expectations, not just those who exceeded them.

Because DHS is currently in the process of completing proposed regulations for its new personnel system, the regulatory process restricts the Department from discussing any details before they are finalized and published in the Federal Register. However, a key point to share is that there will not be a reduction in pay or benefits for employees as a result of conversion to the new system.

This week's article spotlights some of the key findings from the Design Team's research on pay for performance, including what it is, the different ways it can be administered, and why organizations use it.

What is Pay for Performance?

In the current GS system, pay raises are generally given to all employees in standard amounts at pre-programmed time intervals (e.g., every 1-3 years). This system, while predictable, has been widely criticized by experts for rewarding individuals for their length of service irrespective of how well they are performing. DHS employees voiced similar concerns, stating the current system does not recognize differences in performance because employees get paid the same regardless of how hard they work.

Pay for performance is the concept of providing a pay increase, bonus, or other reward based on "performance" (e.g., achievement of a performance goal or positive performance appraisal rating). Organizations tie pay to performance in various ways. They may base pay on measures of individual, team, or organizational performance. They may use performance pay in combination with other types of pay increases and rewards, such as a market-based or cost-of-living increases, or bonuses provided through an awards program.

At the Federal Aviation Administration (FAA), employees are evaluated and rewarded based on individual and organizational performance. Each year, all employees in good standing receive a pay raise based on achievement of organizational goals. High performers are also eligible to receive an additional "merit" pay increase based on the accomplishment of their individual performance goals. Pay increases are not provided to poor performers or employees with conduct issues.

At organizations such as Verizon, Anheuser-Busch, and General Electric, pay raises are based solely on individual performance. The amount of an employee's merit increase is based on their performance appraisal rating. These increases can be a fixed dollar amount or a percentage of salary. For example, all employees rated "satisfactory" might receive a nominal increase and all employees rated "outstanding" might receive a higher amount.

Cost control is a significant issue for many organizations with pay for performance systems. To control costs, some organizations use mechanisms such as forced distribution in their appraisal process, in which managers have limits on the number of employees that can be rated in each category. The problem with force distributions is self evident: What happens when more than the allocated percentage performs at an exceptional level?

In response to this problem, other organizations use pay pools to control costs. With this approach, there are not limits on the number of employees in each rating category, but the amount of the merit increase may vary as a function of the available budget (or size of the "pay pool") and the distribution of performance ratings. Some experts believe that a pay pool approach increases fairness and consistency. They suggest that performance ratings more accurately reflect true performance levels as employees with the same rating receive equal salary increases, rather than trying to force-fit predetermined quotas.

Why Have Pay for Performance?
Tying pay to performance allows organizations to provide monetary incentives to encourage employees to perform at their highest level, benefiting both the organization and individual employees. From an organizational perspective, pay for performance reinforces an organization's mission by motivating peak performance and rewarding behaviors that support organizational goals. From an employee perspective, it recognizes individual contributions and provides employees with greater control over their earning potential. This two-way benefit is the primary reason many organizations opt for some form of pay for performance.

We Welcome Your Thoughts
If you have any suggestions regarding pay for performance or about the personnel system in general, please e-mail them to hrdesign@dhs.gov.

Link to previous edition: Widespread interests in streamlining discipline and appeal process, HR Design News Corner - December 12, 2003